Alberta economic trends

April 2012

Alberta economy remains strong in early 2012

Alberta's economy continues to show signs of strength in the early part of this year. Business output continues to expand at a solid clip, with manufacturing shipments and exports opening 2012 well above last year's levels. Building activity is also primed for a good year, as reflected in an uplift in investment intentions and a stronger start to residential construction.

Meanwhile, households are also doing their part, as a healthy labour market is supporting robust gains in retail spending.

Key Indicators - All indicators seasonally adjusted unless otherwise indicated.

Indicator	Latest Month	Value	Change (year-over-year)
Employment (thousands)	March	2,132	3.1%
Unemployment Rate	March	5.3%	-0.4p.p.
CPI Inflation	March	1.7%	-0.3p.p.
Retail Sales	February	$5.61B	+9.1%
Housing Starts (annualized)	March	35,500	+69.9%
Rigs Drilling (unadjusted)	April	141	+14.4%
Manufacturing Shipments	February	$6.5B	+18.4%
Exports	February	$7.9B	+16.7%

Source: Statistics Canada, CMHC p.p.= percentage points.

Some Signs of Improvement for the Global Economy

Despite ongoing uncertainty, some hopeful signs have emerged for the global economy early in 2012. In the US, the long-struggling labour market has improved, with a first quarter improvement in job growth pushing the unemployment rate down to a three year low of 8.2%. A stronger labour market bodes well for consumer spending, which has started to pick up. Still, many more jobs are needed to move the jobless rate even lower, as sidelined workers rejoin the labour force.

Across the Atlantic, tensions from the European debt crisis have eased in recent months. Much of the improvement can be traced to actions by the European Central Bank (ECB) to inject liquidity into European banks through the provision of low-cost loans to private banks. The deal struck in Greece, where bondholders took losses on Greek debt, prevented a default and eased more immediate concerns. Though tensions have subsided, the crisis is far from over. The focus has now shifted more on how to deal with the elevated debt of other troubled countries, such as Italy, Spain and Portugal.

Despite some better than expected news in Europe and the US, not all is rosy for the global economy. Crude oil prices have driven up gasoline prices across advanced economies, which threatens to cramp consumer spending. There are signs of a slowdown in the Chinese economy; first quarter GDP growth of 8.1% was the lowest level in 3 years and the manufacturing HSBC purchasing managers index has signaled contraction for five consecutive months.

Weighing the positive and negative signs, most forecasters have slightly upgraded their outlook for the global economy in 2012 after numerous downgrades in 2011. The IMF upped its global growth forecast, from 3.3% in January to 3.5%, earlier this month based mainly on developments in the US and Europe.

Business Sector

Oil activity drives business sector gains

In last month's *Economic Trends* issue, we reported that investment in Alberta is surging. Total business investment is expected to hit a record $74 billion this year, thanks to a 16% increase in oil and gas investment - most of which is oil sands related.

Elevated oil prices have supported the investment surge. In March, the WTI price averaged US$106/bbl, the highest monthly level in nearly a year, before moderating slightly this month. Rigs drilling, the most timely measure of oil and gas activity, remains strong overall. After being weighed down by an early spring break-up in March, the number of rigs drilling bounced back in April, up 14.4% year over year (y/y). Through the first four months of 2012, rigs drilling are 4.7% above the same time last year.

The expansion in the oil patch continues to fill the gap left by weakness in the natural gas sector. With US shale flooding the market and warm weather depressing demand, natural gas prices have fallen to around 10 year lows. Low prices and high inventories have weighed on drilling activity, with February gas meters drilled down 31% over the same month last year.

Output maintains strong upward trend

The value of industry output continued its ascent early this year. Manufacturers increased their shipments in both January and February. Year to date, shipments are now tracking 17.5% ahead of the same period last year, led by gains in refined petroleum products, machinery, and primary metals. Exports have also followed an upward trend, rising every month on a year-over-year basis since December 2009. The pace of this growth has slowed from over 20% y/y in the second half of 2011, but still remained a robust 15% y/y in the first two months. Energy and agriculture sectors have been key drivers of exports, rising on the back of strong prices. However, in more recent months, exporters of machinery and equipment have also emerged as strong performers (see chart 1, pg. 2).

Construction primed for a good year

A number of indicators suggest the construction industry is gearing up for a stronger year in Alberta. Investment intentions

in the province are up sharply for this year, and home builders are off to a much better start. Housing starts in the first quarter are 50% above last year's levels, although this partly reflects unusually weak home building in early 2011. Still, starts are on an upward trend, rising in each of the last four quarters. Non-residential construction has also started the year on a more positive note: after 6 straight quarterly declines, non-residential construction recorded its second straight increase in the first quarter of this year. Finally, while building permits fell back from very elevated readings in February 2011, they have otherwise seen double digit year-over-year gains since July.

Household Sector

Job creation resumes in March

After a brief pullback in February, Alberta returned to positive job growth in March, the tenth increase in the last twelve months. In total, 4,400 net jobs were created, partly offsetting the 7,200 lost in the previous month. However, with more people joining the labour force than jobs created last month, the unemployment rate rose from 5% to 5.3%, tied with Manitoba for second lowest in the country. Over the past year, Alberta has added 64,900 jobs, all in private sector positions.

A strong labour market has likely contributed to higher wages: Alberta's average hourly wage rate was up 3.2% y/y in March, well outpacing the rise in consumer prices (see pg. 3-4 for discussion on inflation).

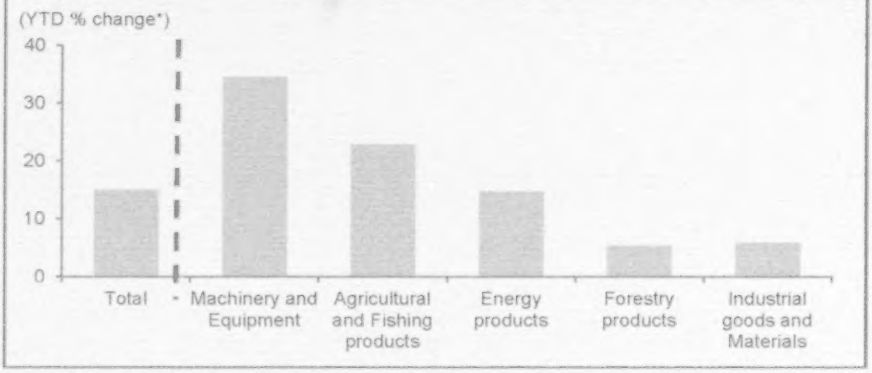
More people call Alberta home

Job opportunities appear to be luring people to the province. The latest estimates from Statistics Canada show that the population was 3,817,980 as of January 1, 2012, an increase of 75,787 people from a year earlier. An influx of migrants gave Alberta the fastest growing population in Canada last year, at 2.03%. Interestingly, Alberta was the only province to record a net inflow of interprovincial migrants in the fourth quarter of 2011 (see chart 2). Over half of these people came from two provinces: Ontario and B.C.

Jobs, and wages lift consumer spending

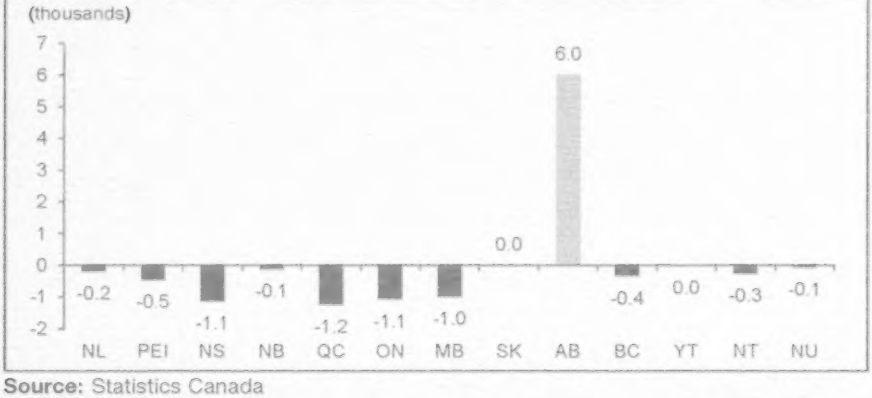
The combination of robust job creation and steady income gains is paying dividends for Alberta retailers. In the first two months of this year, Albertans spent $11.3 billion on retail goods, a 10% increase above levels from the same time last year. While gains were fairly broad based, one category of purchases - vehicles and parts - has stood out in recent months. Spending on these items surged 23% year-to-date, contributing to about half of Alberta's gains. Over this period, consumers have also opened their wallets for housing related goods, such as furniture and home furnishings (19%) and building materials (11%).

Chart 1: Growth in Alberta Exports



Source: Statistics Canada
* Jan - Feb 2012 compared to Jan - Feb 2011

Chart 2: Net interprovincial Migration, Fourth Quarter 2011



Source: Statistics Canada

Alberta's soaring machinery exports: where are they going?

Oil exports are integral to Alberta, garnering most of the attention due to their size. But a lesser known fact is that exports from the machinery industry have outpaced almost all other industries, including oil and gas extraction, in recent months. They were up 54% y/y to $300 million in February, and for the year 2011 advanced by 50%. Alberta's machinery exports are mostly oil and gas related, a sign that manufacturers are leveraging the province's relative strength in energy. Major resource producers such as the UAE, Russia, Australia, Norway and Mexico all fall in the top 10 markets for Alberta's machinery exports.

The US is by far the largest purchaser of Alberta's machinery, and a recent surge in tight oil activity may be lifting Alberta's performance in this area. But, over the last 10 years, Russia, China, Australia, and Columbia have been the main export growth markets, increasing their purchases of Alberta machinery at a clip of more than 20% a year, well ahead of the 10% annual gain in the US. Last year alone, China's purchases of Alberta equipment more than tripled.

Alberta inflation: core pressures stay contained

Alberta's inflation rate has largely been driven by volatile energy and food prices. Other major components of the Consumer Price Index (CPI), such as housing, have remained more stable and subdued. This infocus looks at drivers of Alberta's recent consumer price inflation, and compares the current environment to the high inflation period of 2005 to 2008.

Recent inflation driven by highly volatile factors

Alberta's inflation rate has moved a great deal over the last year. After starting off 2011 at around 1%, inflation picked up to around 3% during the second half of 2011 and into the first month this year. However, in February and March, inflation has fallen back below 2%, with the latest month's reading at 1.7% .

What's been driving these swings? Most of second half run-up and subsequent decline in inflation can be attributed to volatile energy and food prices. In fact, underlying inflation pressures, as measured by CPI inflation excluding energy and food components (a measure of core inflation), have remained fairly muted and stable below 2% over the last year.

The main driver of the past changes in CPI inflation has been energy prices. The cost of energy, which consists mainly of gasoline, electricity, and natural gas, accounted for over half of the growth in Alberta's inflation rate between August 2011 to January 2012, increasing by an average monthly pace of 18.9% y/y. In February, energy price increases started to eased, pulling down Alberta's overall inflation rate from 2.9% in January to 1.7% last month.

Electricity prices contribute to 2011 run-up

Within the energy basket, electricity prices have been the single most important driver of inflation. The cost of electricity increased by 28.5% in 2011. In October 2011 alone, electricity prices shot up 71.1% y/y. According to Alberta Energy, electricity prices have been mainly affected by supply issues, with certain power plants facing unplanned outages. These outages are being resolved and the regulated electricity rate has fallen in the spring, resulting in lower electricity bills. In February and March, electricity prices dropped significantly, by 6.3% and 27%, respectively, and have been the single most important reason Alberta's inflation rate has come down. April's regulated rate fell 13% on average, which will again put downward pressure on Alberta's inflation rate this month.

Gasoline prices elevated, but now adding less to inflation

Gasoline prices also contributed to rising inflation in 2011, jumping by 19% during the year. However, since January, the annual rate of increase has subsided, with March's year over year gain in gasoline prices coming in at a more modest 2.3%.

Natural gas prices continue to fall

Not all energy items have added to inflation. Natural gas prices continue to be weighed down by the glut of supply, falling by an average of 1.4% y/y over the last period.

Food prices pushing up inflation

Food prices have also added to inflation, with an average increase of 3.3% y/y over the latest 12 month period, led by higher meat, dairy products, and eggs. One of the contributors in 2011 was higher prices of feed grain (corn, barley, oats, etc.), a major input in the production of meat and dairy products.

Inflation Moderators

Housing, vehicle costs keep inflation in check

While energy and food prices have added to Alberta's inflation, the cost of housing has helped to contain inflation. In the last year, the average growth of rent was only 0.5% y/y each month, while new housing prices increased by 0.3% y/y on average over the same period. Vehicle costs also helped to moderate inflation, with the cost to buy or lease a passenger vehicle falling 0.2% y/y on average each month over this period.

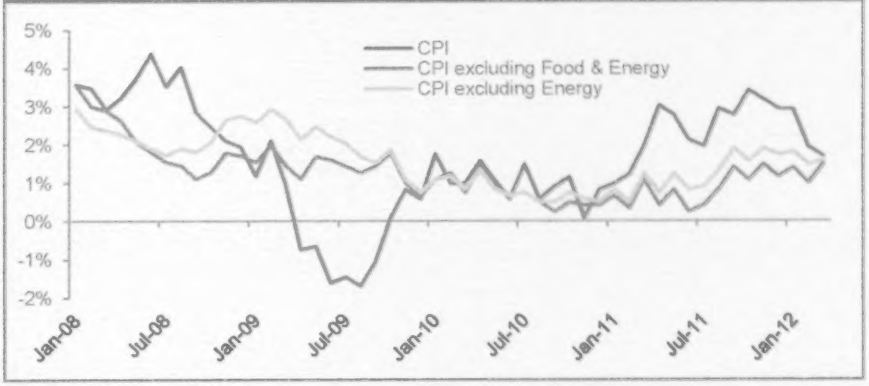
Another factor shaping Alberta's moderate inflation readings is the external environment. Global inflation has fallen from pre-recession levels. Much of this reflects the state of the global economy; demand remains weak and many economies continue to operate below their productive capacity. Like Alberta, inflation at the international level was driven by food and energy prices in 2011. However, the IMF is forecasting global inflation to ease from 2012 through to 2016, due to a more moderate pace of world growth and less upward pressure from commodity prices (see chart 4).

A comparison to the 2005-2008 high inflation years

Despite a strengthening economy, Alberta is not seeing the same high inflation readings experienced during the last period of high inflation, 2005 to 2008. To help understand why, we decomposed 2011 inflation into various components in Chart 2. As shown, last year's inflation was not as broad based compared as the 2005 to 2008 period. In 2011, inflation was primarily due to electricity, gasoline and food.

In comparison, 2005 to 2008 inflation was broad-based across several components, with housing costs contributing significantly. Housing added 1.9 percentage points on average to inflation in 2005 to 2008, more than six times the 0.3 percentage point contribution

Chart 1. Alberta Inflation - the effects of food and energy



Source: Statistics Canada

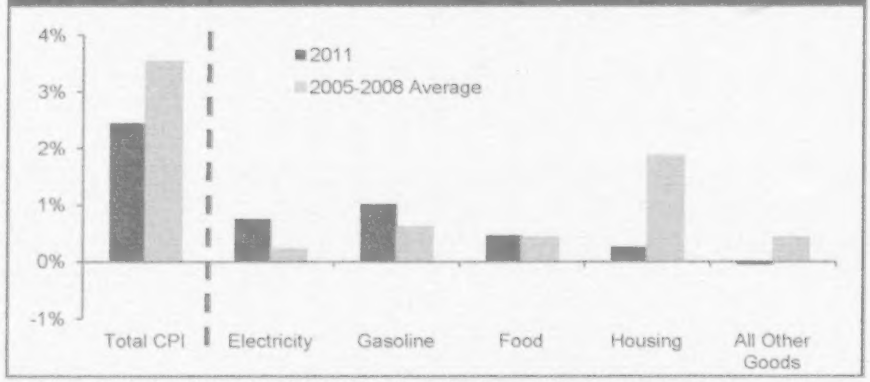
in 2011. In fact, relatively stable house prices have helped keep Alberta inflation below the national rate for most of the last two years (see chart 3).

Implications

Some of the factors that have driven up Alberta's inflation rate are notoriously volatile, and are not expected to persist. In particular, energy prices should not exert the same push on inflation that it did in 2011. While energy prices are expected to stay elevated, they are likely to grow at a slower rate than over the past year. In particular, the upward pressure from Alberta's electricity prices is expected to ease further. While the outlook for food inflation is uncertain, a recent moderation of grain prices may ease production costs and help contain food price inflation.

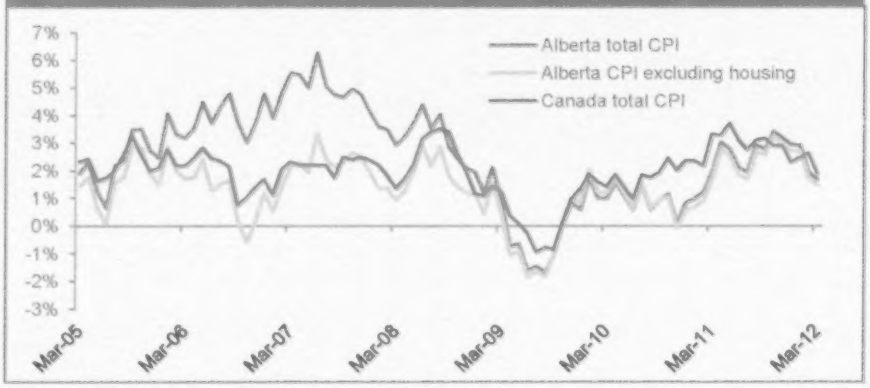
Looking forward, there are several upside risks to inflation. Alberta's economy is strengthening, and there is a risk that a tightening of Alberta's labour market could put pressure on labour costs, which may pass-through to higher prices. In addition, housing prices have remained low and stable despite a strong labour market and robust economic growth. If the price of housing begins to pick up, this could have a significant impact on inflation, as housing comprises about one-fifth of the CPI basket. Finally, an unexpected lift from energy prices, due to possible oil supply disruptions, could lead to firmer headline inflation.

Chart 2. Contribution to Alberta Inflation (percentage points)



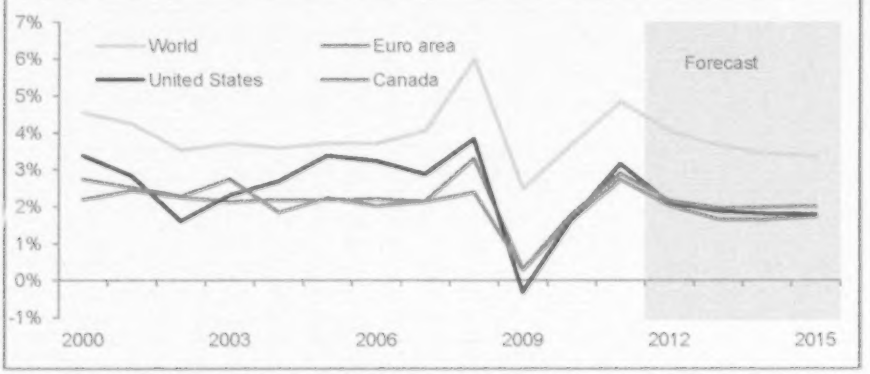
Source: Statistics Canada, Alberta Finance. Housing excludes energy items.

Chart 3. CPI Inflation, Alberta and Canada



Source: Statistics Canada

Chart 4. Global Inflation Trends



Source: International Monetary Fund

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